FOR ARGUMENT

Supreme Court, U. S.
FILED
APR 14 1978
MICHAEL RODAK, JR., CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-693

HONORABLE HUBERT L. WILL, Judge, United States District Court for the Northern District of Illinois,
*Petitioner,*

v.

CALVERT FIRE INSURANCE COMPANY,
*Respondent,*

and

AMERICAN MUTUAL REINSURANCE COMPANY,
*Respondent.*

**On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit**

## REPLY BRIEF FOR THE PETITIONER

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## REPLY BRIEF FOR THE PETITIONER

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### 1. Introduction

Respondent Calvert's brief is apparently predicated on the assumption that Calvert is the true plaintiff in the underlying

controversy between it and American Mutual Reinsurance Company and that the latter initiated the state court action when it was "a potential defendant in an action under SEC Rule 10b-5 . . . ." Calvert Brief at 2. Accordingly, it implies that the federal court action before Judge Will is the basic suit between the parties.

As even a brief examination of the facts will reveal, Calvert's federal court action is simply a defensive measure to American Mutual's state court suit.[1] While we regret the necessity for doing so, in light of Calvert's brief, we believe it essential to restate briefly the history of the underlying controversy and the situation which Judge Will faced at the time he determined to stay action in his court.

Calvert, as of January 1, 1974, joined ninety-nine other insurance companies in a reinsurance pool. The pool agreement provided basically that without any cash investment on the part of any member, all would share in the pool's profits or losses for the year 1974. In April of that year, Calvert announced that it no longer considered itself bound and purported to rescind its membership *ab initio* because it had been misled as to the 1973 earnings of the pool. (*See* letter of April 22, 1974, Exhibit B to the state court complaint—not previously printed but attached hereto as an Appendix).[2]

The members of the pool rejected Calvert's allegations and asserted that Calvert was bound for its share of any losses. On

[1] If American Mutual had not brought its state court action, but had simply acquiesced in Calvert's announced withdrawal from the reinsurance pool, Calvert could not have filed an action under Rule 10b-5 for money damages since it had invested nothing and would have suffered no actual or potential damage.

[2] American Mutual's brief in support of the petition for certiorari asserts at page 2 that Calvert's attempted rescission resulted solely from the fact that a wave of tornados in the Middle West in early April had assured that the pool would have substantial losses in 1974.



July 3, 1974, the ninety-nine pool members sued Calvert in the state court for a declaration that Calvert was so bound.[3]

About six months later, on January 10, 1975, after some preliminary motions, but *not* one to remove the action to the federal court, Calvert filed an answer and counterclaim in the state court action. The answer defended on the grounds that Calvert had been induced to enter the pool by material misrepresentations of fact, thus rendering the agreement void *ab initio,* and it pleaded also as affirmative defenses that:

1. the contract involved the sale of a security without registration in violation of section 5 of the Securities Act of 1933;

2. the sale of that security was made by fraudulent practices in violation of Rule 10b-5 under section 10(b) of the Securities Exchange Act of 1934;

3. the securities were sold by false statements in violation of the Illinois Securities Law;

4. the securities were sold by false statements in violation of the Maryland Securities Act;

5. Calvert was induced to enter into the agreement by material misrepresentations of fact;

6. plaintiff American Mutual had no authority to sue on behalf of the members of the pool; and

7. the pool was illegal since it had not obtained the approval of the Illinois Department of Insurance.

Calvert's accompanying counterclaim contained counts under section 12(1) of the federal Securities Act of 1933 for failure to register, under the Illinois Securities Law for false statements, under the Maryland Securities Act for false statements, and a general claim of material misrepresentations. The

[3] Since the reinsurance pool agreement was to continue through the year 1974, Calvert had allegedly committed an anticipatory breach, and any damages for that breach could not be calculated until year end, the suit appropriately took the form of a declaratory judgment action.

first two counts of the counterclaim claimed rescission of the agreement, and the second two counts each requested $2,000,000 in damages.

On the same day, Calvert filed its action in the federal district court before Judge Will alleging in Count I that it had been induced to enter into the pool agreement by false statements and that it had been sold a security in violation of section 5 of the Securities Act of 1933; and in Count II that the sale was in violation of Rule 10b-5 under the Securities Exchange Act of 1934. Count II asked for rescission or, in the alternative, damages in the amount of $2,000,000. Counts III and IV alleged false statements in violation of the Illinois and Maryland securities laws respectively, and Count V alleged that Calvert was induced to enter into the agreement on the basis of materially misleading representations concerning the financial experience of the pool for the year 1973.

As is apparent, Calvert's defenses in the state court proceedings and its claims in the federal case were and are identical except for the alternative relief for money damages under the Rule 10b-5 claim asserted in the federal court, although the total amount of monetary damages sought in both actions, $2,000,000, is also identical. The principal issue in both cases appeared to be whether or not Calvert had in fact been misled when it was induced to enter into the agreement in January 1974. This was an issue which had been pending before the state court since July 1974. Plainly, the two lawsuits, state and federal, involved the same parties and substantially identical issues.

Accordingly, in May 1975, on motion of the pool Judge Will stayed the proceedings in his court and stated:

> "Regardless of its litigating posture in these two cases, Calvert is responsible for raising substantially the same claims in both courts. As would be the case if this were repetitive litigation, the same elements of duplication of effort and extra burden to the courts



> are present. As Professor Vestal concluded in his scholarly work dealing with reactive litigation, the press of litigation facing the courts highlights the need to curtail or eliminate unnecessary reactive litigation, not only to conserve judicial manpower but also to avoid the unseemly race to judgment with its concomitant harrassment and confusion. Vestal, *Reactive Litigation,* 47 Iowa L. Rev. 11 at 28 (1961). Accepting reactive litigation as merely another form of duplicative litigation imposing similar burdens upon the courts and litigants, we find the positioning of Calvert as defendant-counterclaimant in the state suit and plaintiff here to be of little consequence, and not to preclude our exercise of discretion permitting the state court to adjudicate the 1934 Act defense.
>
> "Nor are we persuaded by Calvert's suggestion that we should assume jurisdiction because the paramount issues are federal in nature. While we agree that, all things being equal, federal courts are the preferred forum for considering securities questions arising under federal law, the Seventh Circuit in *Aetna* [*State Bank* v. *Altheimer,* 430 F.2d 750 (7th Cir. 1970),] stressed a corresponding need for judicial economy. Since this is a question of discretion and not jurisdiction, we find, as in *Aetna,* that confining all of the issues before the state court is preferable to simultaneous consideration by both courts of all issues, both state and federal.
>
> * * *
>
> "While it is not determinative, it should be noted that Calvert, as a non-resident defendant in the state court action, apparently could have removed that action to this court and thereby resolved all of the problems of duplication of effort, etc. It chose not to do so and now seeks both to assert its defenses and

counterclaim in the state court and raise the same issues here." *Calvert Fire Insurance Co.* v. *American Mutual Reinsurance Corp.*, No. 75 C 103, slip op. at 9-10 (N.D. Ill. May 6, 1975).

It cannot be denied that Judge Will was faced with a situation where it would have been wasteful and duplicative for him to consider and decide the same issues that were already pending in the state court. Simple common sense and principles of avoidance of duplicative, expensive, and wasteful litigation indicated the desirability, indeed, the necessity, of staying his hand to see whether the state court would dispose of the factual and legal issues without duplicative effort on his part. He preserved his own jurisdiction against the possibility that the expected outcome of a final and conclusive decision by the state courts should not eventuate, and a lifting of his stay might be appropriate.

What is stated now to rebut Judge Will's eminently sensible conclusion, and to require him to engage in a wasteful and duplicative enterprise parallel to and in a race with the state court?

**2. Calvert's "Entitlement" to a Federal Forum**

(a) Calvert's argument in favor of duplicative litigation seems to be that, having filed a reactive or defensive claim in a federal court to a pending state court action, it is "entitled" to a "federal forum" to decide the issue of whether a security exists, apparently because the federal courts have more experience in such determinations. This is a basic attempt to distort the issues.

The definition of "security" is not exclusively the province of the federal courts. Calvert concedes that actions to enforce liabilities under the 1933 Act may be brought in state courts, and that defenses arising under both the 1933 Act and the 1934 Act, including Rule 10b-5, can be adjudicated in state courts. (*See* Calvert Brief at 5-6.) Such defenses have, in fact, been



asserted by Calvert in the state court. The only circumstances under which a federal court is given exclusive jurisdiction is over suits to *enforce* liabilities under the 1934 Act. To the extent that such jurisdiction is given to the federal court it has been preserved by Judge Will's order.

If courts are to be selected on the basis of comparative expertise, certainly the Illinois state court is more expert than a federal court on the meaning of the Illinois Securities Law, as well as on the Illinois insurance law, a violation of which Calvert has also pleaded. Query which court—state or federal—is more "expert" about the Maryland Securities Act? But the fact is that state courts can and must decide questions of federal law such as the definition of security, and that weighing of relative "expertise" is not of such consequence as to compel wasted judicial manpower and duplication of litigation.

(b) Once we eliminate the erroneous concept that only a federal court can decide a question of the application of federal law, and it is clear that there are two court systems equally capable of handling most, if not all, of Calvert's dispute, the argument for the necessity of duplicative litigation disappears.

One count of the federal complaint does, of course, plead a claim for enforcement of an alleged Rule 10b-5 liability, a claim which under the 1934 Act can be brought only in a federal court. Since, as previously indicated, Calvert has invested nothing in the pool and its only possible damages would be its expenses in joining the pool, a negligible amount in comparison with its potential liability as a pool participant, its Rule 10b-5 claim for damages is obviously simply a device to raise some issue over which the federal court has exclusive jurisdiction.

Even this claim, however, has been preserved to Calvert by Judge Will's order in the event that the claim under Rule 10b-5 raised as a defense in the state action does not result in a judgment dispositive of the federal claim. Calvert apparently asserts that an adverse decision by the state court on the Rule

10b-5 defense would not have res judicata effect. (*See* Calvert Brief at 8.) Plainly, that contention, right or wrong,[4] is not ripe for adjudication and Judge Will made a reasonable judgment that the possibility that at some future time there may be a necessity to relitigate some of the issues decided by the state court would not make it wise or reasonable to litigate the entire matter in both courts at the same time.[5]

**3. Calvert's Possible Interest In Delay**

In its brief, Calvert argues repeatedly that it has done everything possible to have its "federal securities issues" adjudicated in a federal court, and contends at page 15 that it would have no "interest . . . [in] delay[ing] . . . obtaining the relief to which it thinks itself entitled . . . ." By these arguments, Calvert attempts to divert attention from the real nature of the litigation. As Calvert admits at pages 7 and 8, it is not seeking to recover money paid to American Mutual. It has not paid any money and despite the language of its answer and counterclaim apparently is not in fact claiming any money. Rather, Calvert's purpose is to avoid paying money which American Mutual maintains has long since been due.[6] Therefore, it might plainly be to Calvert's interest to delay the day when it might have to account to American Mutual. It is not necessary to decide whether this is in fact Calvert's purpose, but we point out the possibility in reply to Calvert's suggestion that no such interest exists.

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[4] *Cf. Cramer* v. *General Telephone & Electronics,* 443 F. Supp. 516 (E.D. Pa. 1977).

[5] Moreover, as the discussion, *infra* p. 13-14, points out, Calvert could have had a federal forum and obviated the problems of duplication and waste of judicial time and effort had it removed the state court action to the federal court, which it chose not to do.

[6] For this reason, Calvert's federal claim may not in fact be one "to enforce any liability or duty created by" the 1934 Act, and therefore section 27, 15 U.S.C. §78aa, may not confer exclusive jurisdiction on the federal court. Rather than decide such a technical issue that might ultimately be rendered moot, however, Judge Will stayed adjudication.



As for the suggestion that this case is about complex technical issues of federal securities law, it should be noted that the essence of Calvert's federal action, just as the essence of its defenses in the state action, is that it was materially misled by American Mutual prior to its entry into the reinsurance pool. If Calvert was in fact misled, that would be grounds for recovery under state law principles of deceit and equitable rescission as well as under Rule 10b-5. Indeed, a state cause of action would probably be easier to establish, because under Rule 10b-5, Calvert would have to prove scienter, *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976); *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 472-74 (1977), while rescission of its obligations may be obtained under state law even for innocent misrepresentations if material.

The federal securities laws do, of course, provide certain securities purchasers with a cause of action simpler in its elements than common law deceit or equitable rescission, *viz.,* section 12(1) of the Securities Act of 1933, 15 U.S.C. §77*l*(1).[7] But the federal courts do not have exclusive jurisdiction under the 1933 Act; Congress specifically provided in section 12(1) that suits may be brought "in any court of competent jurisdiction" including of course state courts. Under the circumstances the question arises why Calvert has chosen to emphasize the Rule 10b-5 claim over which federal courts have "exclusive" jurisdiction. Can it simply be a tactic to delay an adjudication of whether or not it is entitled to abrogate its membership in the reinsurance pool and possibly also to secure a second forum in which to litigate the underlying factual questions, in the hope of securing conflicting results?

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[7] It is not disputed that if Calvert's participation in the reinsurance pool was a "security," it was not registered under the 1933 Act, and Calvert has alleged that registration was required. No discussion appears in the federal complaint, however, of the application of section 12(1) giving a right "to recover the consideration paid," we assume because no consideration has been paid by the plaintiff.

**4. Federal Jurisdiction Has Not Been Denied**

Calvert repeatedly contends that district courts have a "virtually unflagging obligation" to exercise jurisdiction. This is correct. However, no matter how often Calvert repeats its assertion that Judge Will has disclaimed jurisdiction over Calvert's complaint, that simply is not true. As discussed at length at pages 15 through 20 of our initial brief, Judge Will has expressly retained jurisdiction over Calvert's claim, and the consequences of a stay of litigation are entirely different from the consequences of a dismissal finally disposing of the case by rejecting jurisdiction. Plainly the stay is subject to being lifted at any time on a showing of good cause. *See Landis* v. *North American Co.*, 299 U.S. 248, 257 (1936).

**5. Res Judicata Effect**

At pages 8-9 of its brief, Calvert argues that whether or not a state court determination of the "security" question would have res judicata or collateral estoppel effect in federal court, Judge Will should have acted immediately. Calvert's argument is plainly misguided.

To the extent that a state decision adverse to Calvert on the security question would not be binding in federal court, Calvert was not prejudiced by Judge Will's stay.

Calvert suggests, at page 14, that we have used "moot" as a euphemism for "barred by res judicata or collateral estoppel." Calvert in making this argument apparently has overlooked the possibility that it will make good its allegations that it was misled, that it may be successful in the state litigation, and that the state court will grant Calvert the relief it has claimed on the ground that it was in fact misled into joining the pool. At that point, Calvert would have nothing left to seek in the federal action and the case before Judge Will would truly become moot.

On the other hand, a conclusion against Calvert in the state action might also be determinative of all issues.



Because of these possibilities, Judge Will realized that judicial efficiency favored staying resolution of the case before him pending the outcome of the state proceedings, which might make it unnecessary to decide the issue, which Calvert states at page 9 is complex, of the collateral estoppel effect to be given state court findings.

**6. The *Beacon Theatres* Analogy**

On page 9 of its brief, Calvert suggests a "powerful" analogy between the instant case and *Beacon Theatres, Inc.* v. *Westover*, 359 U.S. 500 (1959). What Calvert fails to point out, however, is that *Beacon Theatres* held only that mandamus was appropriate to protect against the deprivation of the constitutional right of trial by jury, a point on which majority and dissent in that case agreed.

Plainly, Calvert has no right, as we have shown, much less a constitutional right to a federal determination of whether a "security" was involved in the reinsurance pool, and its possible right to the exclusive jurisdiction of the federal court on its Rule 10b-5 claim has been preserved by Judge Will's stay order.

Further, *Beacon Theatres* supports judicial discretion and denies the right to mandamus where discretion exists. See, for the majority, Justice Black's opinion, 359 U.S. at 510. Even more clearly for the dissent, Justice Stewart stated:

> "There can be no doubt that a litigant is entitled to a writ of mandamus to protect a clear constitutional or statutory right to a jury trial. But there was no denial of such a right here. The district judge simply exercised his inherent discretion, now explicitly confirmed by the Federal Rules of Civil Procedure, to schedule the trial of an equitable claim in advance of an action at law. Even an abuse of such discretion could not, I think, be attacked by the extraordinary writ of mandamus." 359 U.S. at 511-12 (Stewart, Harlan & Whittaker, JJ., dissenting) (footnote omitted).

On the issue of the inappropriateness of mandamus relief where the trial court has discretion, we believe the Court was unanimous. The justices disagreed only on whether a constitutional right to jury trial was being taken away.

We submit that, when anything less than a constitutional right is at stake, *Beacon Theatres* supports the proposition that "the trial court will necessarily have to use its discretion," 359 U.S. at 510, and that therefore mandamus relief is clearly inappropriate. See also *Black* v. *Boyd,* 248 F.2d 156, 161 (6th Cir. 1957), and *Black* v. *Boyd,* 251 F.2d 843, 844 (6th Cir. 1958), cited by Justice Stewart in note 1 to his dissenting opinion in the *Beacon Theatres* case, 359 U.S. at 512.

**7. The Significance of *Landis*.**

While we would wish to respond to Calvert's blunt assertion at page 12 that "[n]othing in . . . the decision under review negates the general proposition of *Landis* [v. *North American Co.*, 299 U.S. 248 (1936),] that 'the power to stay proceedings is incidental to the power inherent in every court to control the disposition of the causes on its docket,'" we are unable to comprehend Calvert's argument sufficiently to respond to it. The thrust of Calvert's brief is that despite, indeed because of the pendency of duplicative proceedings in state court, Judge Will had no discretion, none whatever, to stay the proceedings before him. How this can be reconciled with *Landis* is difficult to understand.

Perhaps the solution lies in Calvert's allegation that to protect the jurisdiction of the federal courts they must exercise that jurisdiction even if it is wasteful and duplicative because it will replicate state litigation involving the same legal issues over which the state courts concededly also have jurisdiction. Plainly there is no support for such a curious proposition. *See, e.g., Langnes* v. *Green,* 282 U.S. 531, 542-44 (1931). Moreover, the logical thrust of such a contention would seem to be not that Judge Will was without power to stay proceedings, but



that he acted unwisely in doing so. In that event, mandamus would not be available as a remedy.

It should be noted that, despite Calvert's remarks about "the federal-state context," *Landis* can in no way be seen as limited to an instance of one federal court deferring to another. The *Landis* Court permitted the trial judge to await the outcome, not of duplicative litigation between the same parties, but of a completely different case involving different parties solely because it might clarify a purely legal question. *See also Kansas City Southern Railway* v. *United States,* 282 U.S. 760, 763-64 (1931):

> "[T]he existence of jurisdiction does not mean that it must be exercised and that grounds may not be shown for staying the hand of the Court . . . . The question is thus one for the sound discretion of the District Court, in which such a suit is brought, to determine whether it should be permitted to continue or proceedings therein should be stayed, pending the final outcome of an earlier suit for the same purpose, to the end that there may not be a multiplicity of suits without substantial reason."

The only issue in *Landis* was whether an ancient well-established rule permitting—if not requiring—stays to avoid duplication in litigation between the same parties could be extended to cases of parallel suits by other parties. *See* 299 U.S. at 254. Surely, the *Landis* Court would have permitted a judge to stay proceedings while in another court the same parties attempted to get the same relief on substantially the same grounds.

**8. Calvert's Failure To Remove**

Having argued repeatedly in its brief that the issue before this Court is a very narrow one relevant only to instances "[w]hen a potential defendant in an action under SEC Rule 10b-5 . . . institutes litigation by bringing a state court action for

a declaratory judgment as to the validity of the relevant contract, and the defendant in that action brings its own federal court action under Rule 10b-5," Calvert then argues on page 10 that its failure to remove the state claim to federal court, which would have solved all the problems of inefficiency and piecemeal adjudication, should not have been considered by Judge Will because "[i]n the last analysis, the diversity of citizenship here was fortuitous," and Calvert's failure to exercise the right of removal was ill-considered. But Congress in granting the right of removal determined that if state court jurisdiction were to be ousted this should be done promptly in a fixed period of time not subject to extention. Calvert's decision not to remove may have been ill-advised, but it was final under the law, and, in the exercise of his discretion, Judge Will properly considered it a factor in his determination that fairness did not require him to expend his judicial resources to grant Calvert a second adjudication of its claim while the state litigation was proceeding.

**9. Conclusion**

It is the right and the obligation of the courts to do as Judge Will has done and avoid duplication to the extent possible. Otherwise, "[w]heels would spin for no practical purpose," *Bankers Trust Co.* v. *Mallis,* 46 U.S.L.W. 4261, 4262 (U.S. 1978). The court below agreed that Judge Will had correctly exercised his discretion, but felt, we submit wrongly, that such discretion had been removed by this Court's decision in *Colorado River Water Conservation District* v. *United States,* 424 U.S. 800 (1976).

For the reasons demonstrated above and in our earlier brief, it is clear that district judges must have, and traditionally have had, discretion over the ordering of their calendars. So long as such discretion exists, it is plainly improper for a court of appeals to issue an extraordinary writ of mandamus to compel a district court either to engage in a race with a state court or to duplicate the state court's efforts.



The judgment of the court of appeals should be reversed, and the writ of mandamus ordered vacated.

Respectfully submitted,

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Dated: April 14, 1978

**Appendix**

Cavalier Insurance Corporation
Calvert Fire Insurance Company
300 ST PAUL PLACE
BALTIMORE, MD. 21202

April 22, 1974

Mr. Wallace Winter, President
AMERICAN MUTUAL REINSURANCE COMPANY
One East Wacker Drive
Chicago, Illinois 60601

RE: Multi-Line Reinsurance Agreement

Dear Mr. Winter:

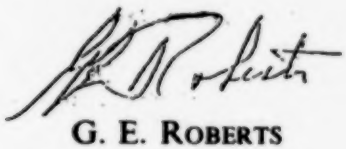
This will supplement my telegram dated April 19, 1974, and also the telephone conversation of April 18, 1974, with our Executive Vice President, Mr. B. K. Vickrey.

One of our considerations for entering the Amreco pool was, of course, your track record over a period of many years and while we realized at the time of our negotiations with your representatives that you may have experienced some adversity in 1973, we were shocked at the final outcome.

It was not until a few days ago when we received your 1973 Annual Report that we had any idea that your loss and expense ratio for 1973 was a terrible 130.1%. Had we had any reason to believe that 1973 would have been so adverse, then you may be sure we would not have agreed to the pool on January 1, 1974.

We feel very strongly that all of the pertinent facts were not provided at the time of our negotiations and ultimate agreement and, therefore, confirm at this time our request for the cancellation of this agreement retroactive to January 1, 1974.

Sincerely yours,



G. E. ROBERTS

GER:ch